

The Kentucky Division of Social Security *...leading the way*

Special Edition

<http://sssa.state.ky.us>

Inside the Tax Relief Act of 2001

The Economic Growth and Tax Relief Act of 2001 (Public Law 107-16) was signed by President Bush on June 7, 2001. The new law contains several items of note for those who work with state and local government payrolls. The following are the important points for payroll officials that we have discovered thus far.

The Division of Social Security has posted to its web site IRS Publication 15-T which includes *New Withholding Tables for 2001* that are effective after June 1, 2001. Publication 15-T supplements IRS Publication 15, *Circular E, Employer's Tax Guide* and IRS Publication 15-A, *Employer's Supplemental Tax Guide*.

The DOSS web site may be accessed via <http://sssa.state.ky.us>

Employer-provided educational assistance

The EGTR Act extends the income exclusion under IRC 127 for \$5,250 of employer-provided educational assistance to graduate education and makes the exclusion (as applied to both undergraduate and graduate education) permanent, effective with respect to courses beginning after December 31, 2001.

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Change in supplemental withholding rate

In addition to the gradual reduction in marginal income tax rates, the new tax law also gradually changes the rates for backup withholding and withholding from supplement wage payments. Effective for wages paid after August 6, 2001 (or as soon as possible thereafter), the supplemental wage flat withholding rate is decreased from 28 percent to 27.5 percent for the remainder of 2001.

The rate for the year 2002 and 2003 will be 27 percent. In 2004 and 2005, the rate for supplemental withholding will be 26 percent.

The rate will be 25 percent for 2006 until December 31, 2010. The provisions of the EGTR Act expire after that date. Without further action by Congress by that time, the supplemental and backup withholding rates could revert back to 28 percent and 31 percent respectively for tax years 2011 and beyond.

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Change in backup withholding rate

Effective for payments made after August 6, 2001 (or as soon as possible thereafter), the backup withholding rate is decreased from 31 percent to 30.5 percent for the remainder of 2001. The withholding rate drops to 30 percent for 2002 and 2003, 29 percent for 2004 and 2005 and 28 percent for 2006 through 2010.

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Increased contribution and benefit limits for retirement plans, and increased elective deferral limits

The dollar limit on annual elective deferrals under 401(k) and 403(b) plans will increase from \$10,500 to \$11,000 in 2002, and then will increase in \$1,000 annual increments beginning in 2003 until the limit reaches \$15,000 in 2006.

The dollar limit on deferrals under state and local governmental 457 plans will increase from \$8,500 to \$11,000 in 2002, and then will increase in \$1,000 annual increments beginning in 2003, until the limit reaches \$15,000 in 2006. After 2006, the limit for 457 plans will be indexed in \$500 increments. In the three years prior to retirement, the limit will be twice the limit otherwise applicable.

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Additional catchup contributions for individuals over age 50

Individuals age 50 or older may make additional contributions to a section 401(k) plan, section 403(b) annuity or may increase deferrals under a section 457 plan. The additional amount of elective contributions that may be made is the lesser of the applicable dollar amount or the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.

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Adoption expense income exclusion

The new tax act permanently extends the exclusion from income for employer-provided adoption assistance. The maximum exclusion is increased to \$10,000 per eligible child, including special needs children. In the case of a special needs adoption, the exclusion is provided regardless of whether the taxpayer has qualified adoption expenses. The beginning point of the income phaseout range is increased to \$150,000.

This provision of the tax act is generally effective for taxable years beginning after December 31, 2001. The special needs adoption exclusion is, however, effective for taxable years beginning after December 31, 2002.

Advanced Earned Income Credit Payment Tables not revised

Despite changes in the earned income tax credit, the IRS has made no revisions in the Advanced Earned Income Credit Payment Tables for 2001.

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Form W-4 for 2001 will not be revised--but....

The IRS will not be revising the Form W-4 for 2001. Employers are instructed, however, to make available to employees a notice that is available on page 63 of Publication 15-T. The notice informs employers that:

- (1) New withholding table will reduce the amount of income tax withheld from their wages after June 30, 2001.
- (2) Reductions in tax withholding are due to reduction in the current 28 percent and higher tax brackets effective July 1, 2001.
- (3) New tables, prescribed by the Department of Treasury reflect a change resulting from the 2001 tax act.
- (4) If employees do not want to have their withholding reduced, they can file a new Form W-4 with their employer claiming fewer withholding allowances on line 5 or requesting additional amounts to withheld on line 6.

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